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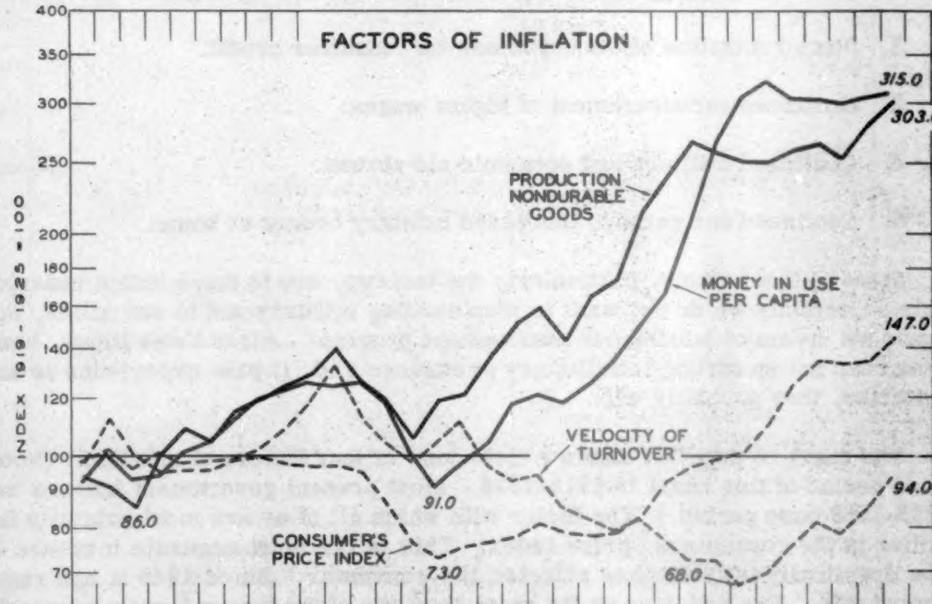
INFLATION OR DEFLATION AHEAD?

WHILE there are undoubtedly many inflationary forces still firmly attached to our economy, there are indications that some of them may be firmly counteracted in the next few months. As a matter of fact, there is pretty strong evidence that some counteraction has already set in.

The Administration is trying desperately to keep the threat of all-out inflation squarely in the public eye. Certainly there is enough truth in their statements regarding inflation and its dire consequences to partially mislead a superficial observer. Few will argue that the threat of inflation has been entirely dispelled. Most will agree that severe inflation is a lethal force regardless of its origin. Whether it is set in motion by money mismanagement on the domestic front or launched by all-out war with the Russians, its results are the same. Of course, we would get more inflation faster in case of war than without it. Even the monetary foolishness of which we are capable will not bring the swift drop in



living standards engendered by total war - but is more inflation imminent from either source?

To begin with, let's dismiss the Russians from this discussion. This is not an attempt at flippancy, but the result of the realization that nobody knows if or when they will start shooting for keeps. Our guess is that they won't for some time to come, and that the trouble we will undergo will be due to our own mistakes, both past and future. Consequently, we will deal with a few available facts concerning the domestic picture.

Despite the government's warnings of dire things to come unless we tighten our belts, our strong belief is that most of our inflation is, and will be, due to the impact of government action in the fields of credit, fiscal policy and industrial production. Looming larger each day is the election year 1952. Is an administration pledged to a policy of full employment likely to allow deflation in an election year? Is it likely to control wages as rigorously as it would like to control prices, and is it likely to seriously sponsor worth while cuts in government spending? Our answer to all three of these questions is "No."

There is already committee talk in Congress of loosening Regulations W and X. Just how lax these regulations will be allowed to become is not known, but it is certain which way the wind is blowing. Furthermore, Congress is hardly apt to pass a tax bill sufficient to cover the prodigious expenditures for next year. Therefore, we see that the course government will follow will, in all probability, be along these lines.

1. Deficit financing to some, perhaps a considerable, degree.
2. Some relaxation of the curbs now on consumer credit.
3. Continued encouragement of higher wages.
4. Continued military and economic aid abroad.
5. Continued and perhaps increased military orders at home.

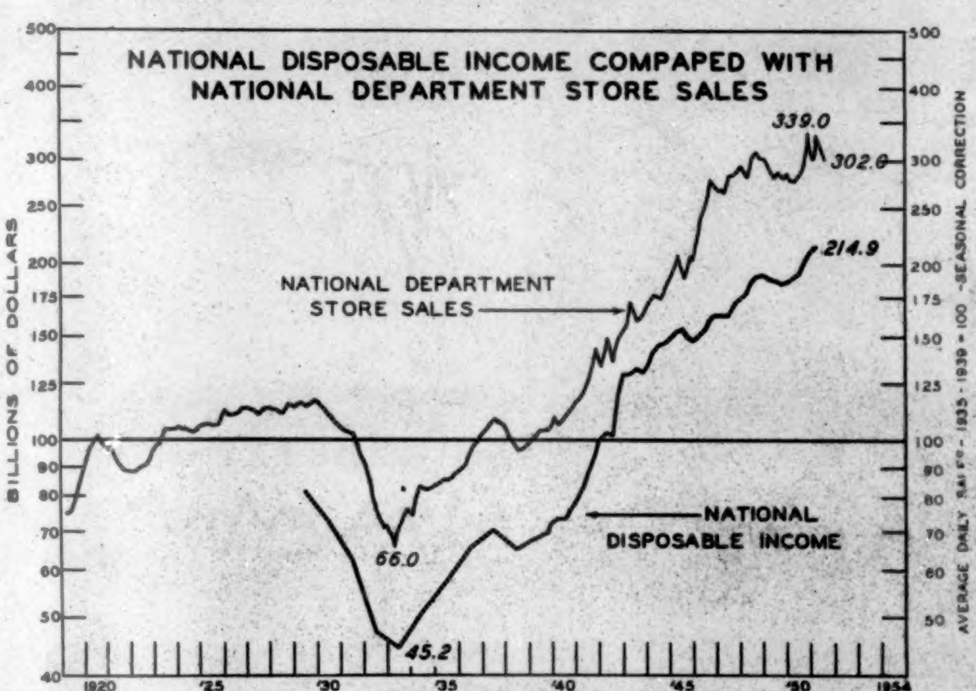
Some of these items, particularly the last two, are to some extent unavoidable. Certainly we do not want to stop sending military aid to our allies, nor would we dream of junking our rearmament program. All of these items, however, can set up strong inflationary pressures and, if past experience is any criterion, they probably will.

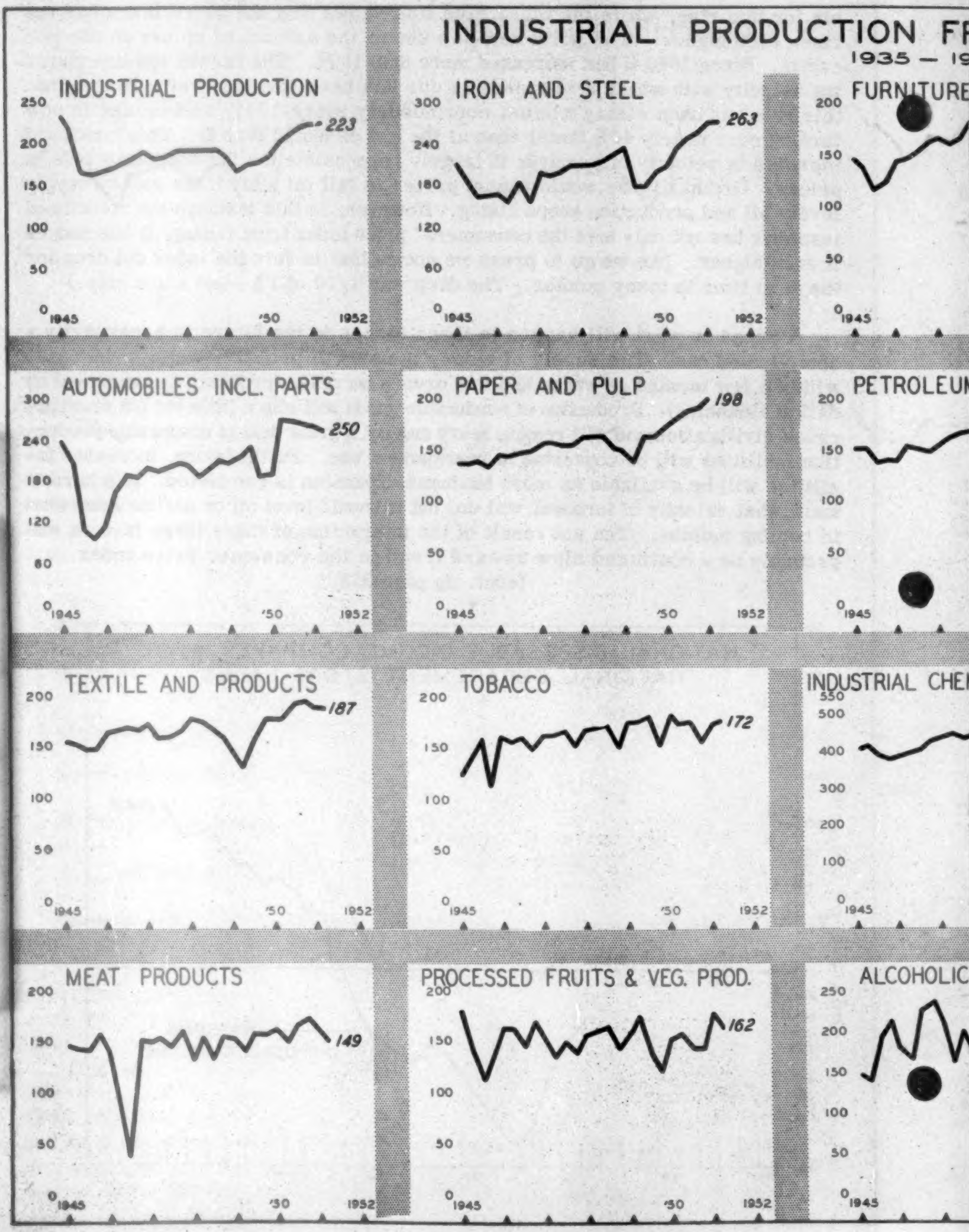
The chart on page 347 shows a clear view of four factors of inflation. (Note: Base period of this chart is 1919-1925. Most present government indexes use 1935-1939 base period.) The factor with which all of us are most painfully familiar is the consumers' price index. This is the most accurate measure of how drastically inflation has affected the consumer. Since 1940 it has risen almost 90%. The red lines on the chart show two of the forces largely responsi-

ble for this rise, while the other blue line shows why the price index has not risen even higher. The solid red line shows the amount of money in use per capita. Since 1940 it has increased more than 130%. The dashed red line shows the velocity with which this money in use has been turning over. Notice that this rate has been rising almost continuously since 1945, and money is now turning over nearly 40% faster than at the end of World War II. This continued increase in velocity of turnover is largely responsible for the continuing rise in prices. Ordinarily we would expect prices to fall off a bit if the money supply levels off and production keeps rising. However, in this instance the velocity of turnover has not only kept the consumers' price index from falling, it has nudged it even higher. (As we go to press we notice that in July the index did drop for the first time in many months. The drop was 1/10 of 1% - not much help.)

A guess on what will happen to these forces in the future is necessarily a complicated one. The supply of money in use will probably begin to increase within a few months as wages and war orders increase (probably accompanied by deficit financing). Production of nondurable goods will slip a little but not much because civilian demand will remain heavy and not a great deal of nondurable production facilities will be converted to rearmament use. Furthermore, increased facilities will be available as more business expansion is completed. It's hard to know what velocity of turnover will do, but it should level off or decline somewhat in coming months. The net result of the interaction of these three factors will probably be a continued slow upward trend in the consumer price index.

(cont. on page 353)




INDUSTRIAL PRODUCTION FR
1935 — 19
INDUSTRIAL PRODUCTION
223
IRON AND STEEL
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FURNITURE
AUTOMOBILES INCL. PARTS
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PAPER AND PULP
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PETROLEUM
TEXTILE AND PRODUCTS
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TOBACCO
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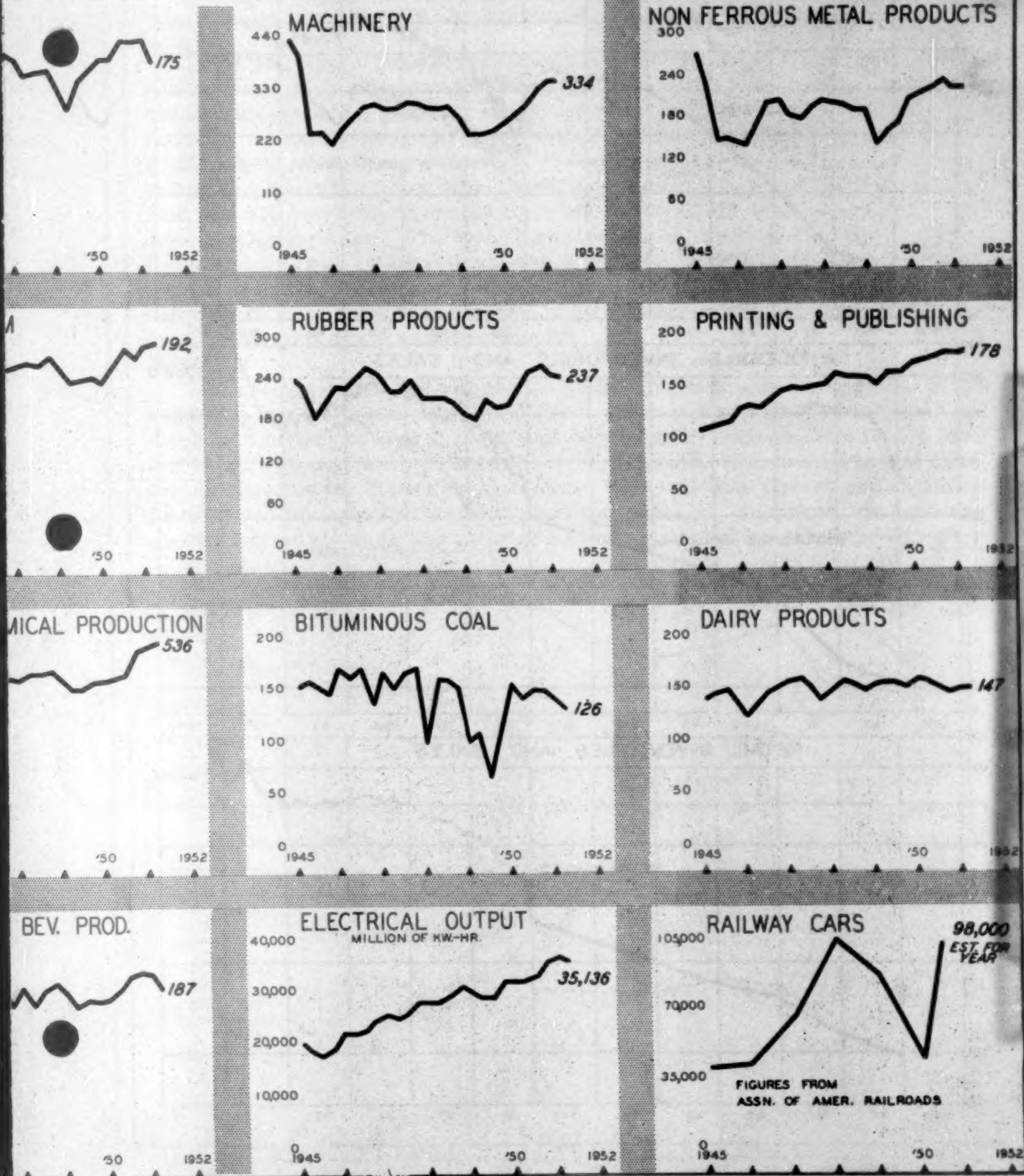
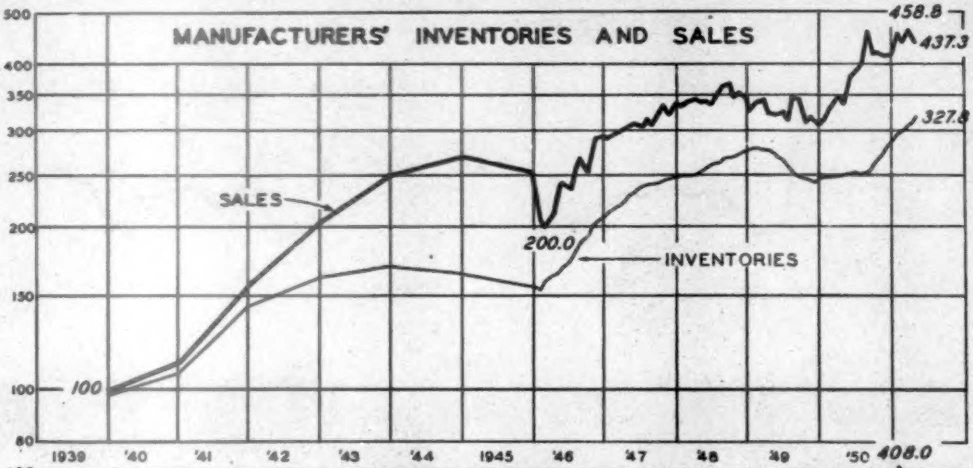
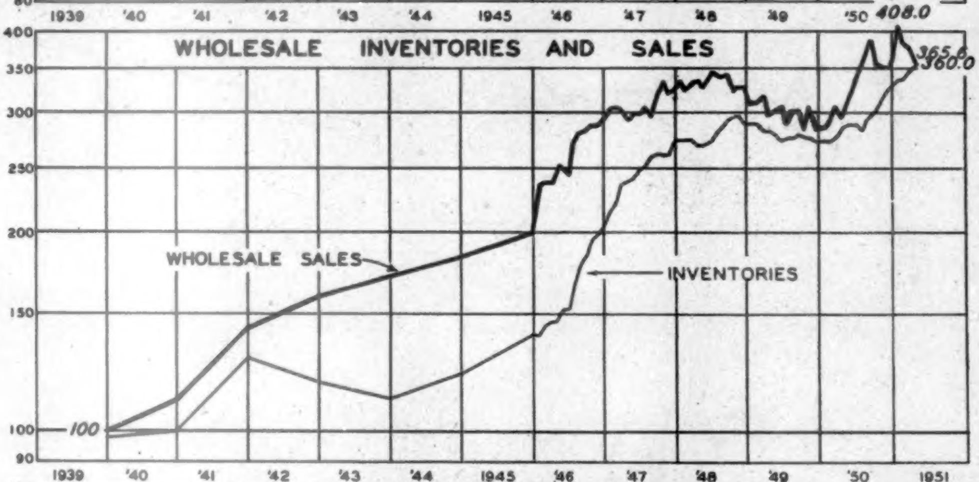
INDUSTRIAL CHEM
MEAT PRODUCTS
149
PROCESSED FRUITS & VEG. PROD.
162
ALCOHOLIC
1945
'50
1952

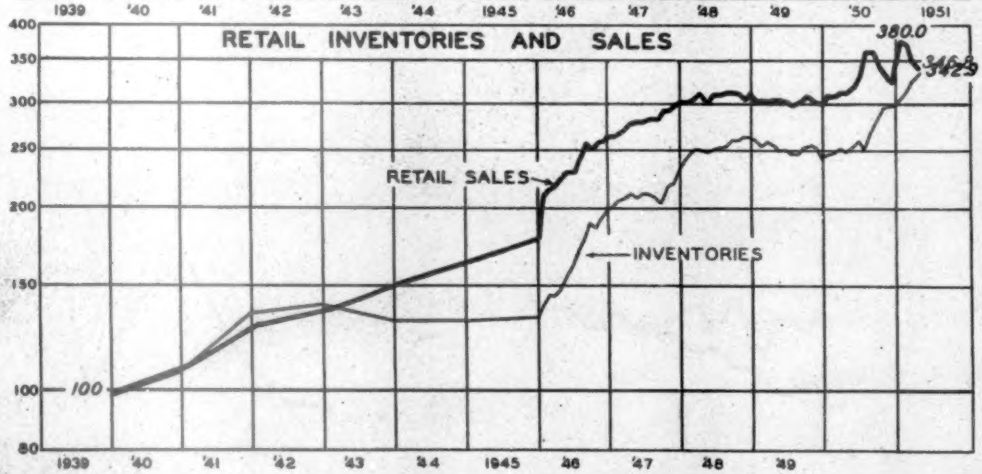
ROM 1945 TO THE PRESENT

39 = 100




MANUFACTURERS' INVENTORIES AND SALES
SALES
INVENTORIES
200.0
458.8
437.3
327.8
100
1939
'40
'41
'42
'43
'44
1945
'46
'47
'48
'49
'50


WHOLESALE INVENTORIES AND SALES
WHOLESALE SALES
INVENTORIES
408.0
360.0
100
1939
'40
'41
'42
'43
'44
1945
'46
'47
'48
'49
'50
1951

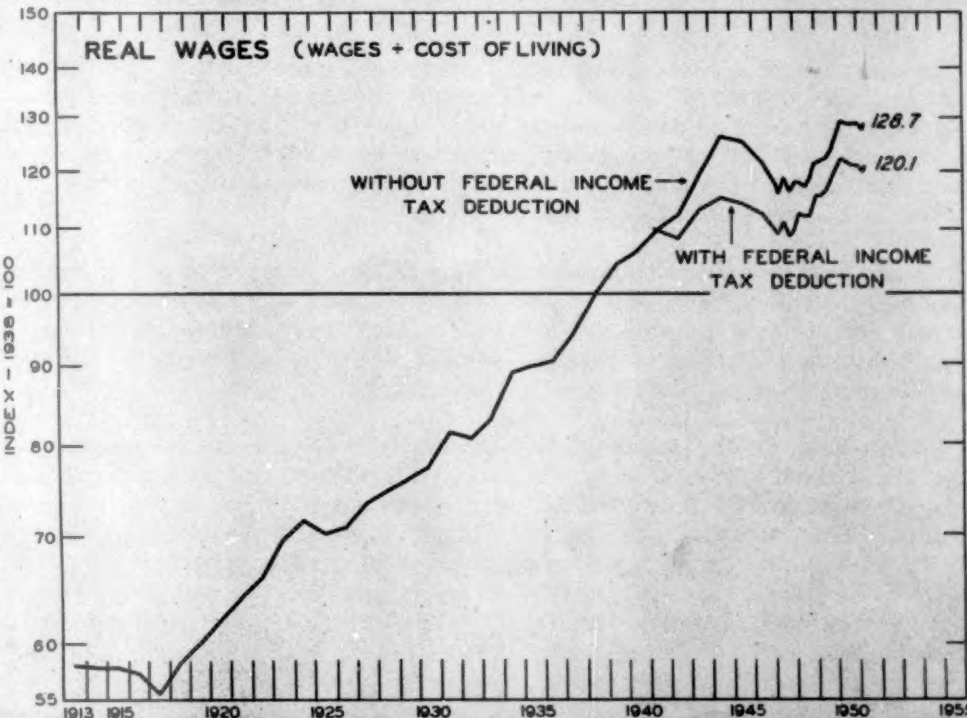

RETAIL INVENTORIES AND SALES
RETAIL SALES
INVENTORIES
380.0
100
1939
'40
'41
'42
'43
'44
1945
'46
'47
'48
'49

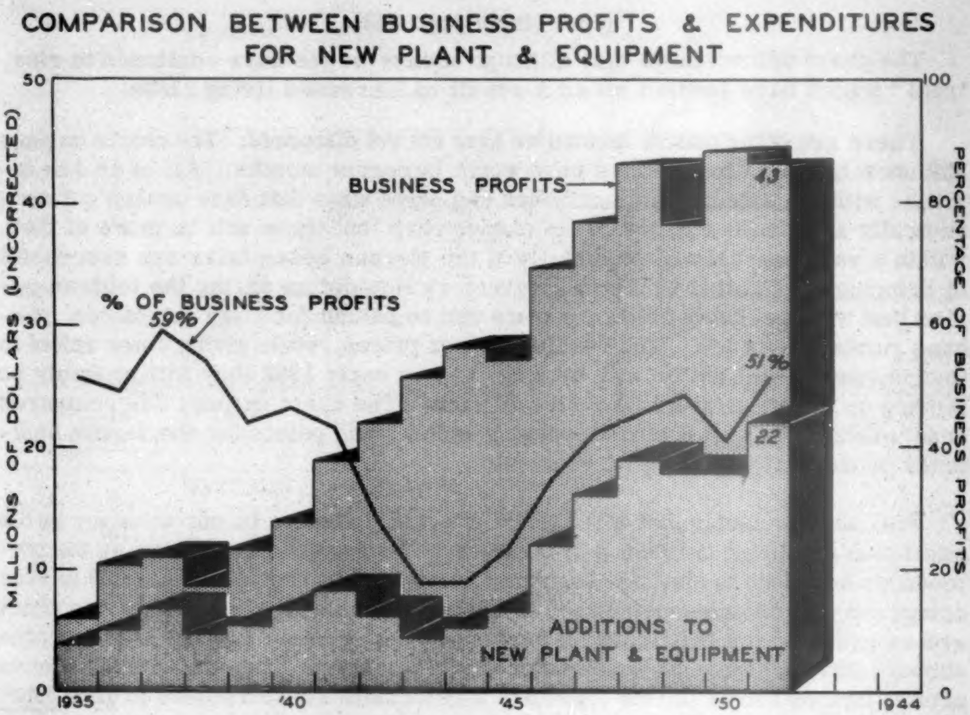
(cont. from page 349)

The chart below shows that although money wages have continued to rise, "real" wages have leveled off as a result of increased living costs.

There are other outside factors we have not yet discussed. The charts on page 352 show how high inventories have risen in recent months. All of us are familiar with the sales, premium offers and price wars that have broken out sporadically across the country. The chances are that there will be more of them within a very short time, especially if the Korean peace talks are successful in bringing the fighting to a stop. Inventory liquidation during the letdown period that will inevitably follow the truce will be painful for many companies, perhaps ruinous for a few. The resulting lower prices, while giving some relief to the consumer, will not be with us long, and by early 1952 they will probably be moving up again, although at a slower pace. The chart on page 349 compares department store sales with disposable income and points out the recent hesitancy on the part of the retail consumer.

Still another factor that will exert a powerful influence on our economy is the expansion now being carried on by business. The chart on page 354 shows the tremendous additions to plant and equipment carried out by business from 1935 to 1951 compared with business profits. The business profits figures used in this chart are exaggerated for the following reason: No up-to-date figures are available showing non-incorporated business profits after taxes. Therefore, the business profits figures shown in this chart are a combination of corporate profits after





taxes plus non-incorporated business and partnership profits before taxes. While this is not good statistical or charting practice, it is not too bad so long as an explanation of the figures is given. The chart shows that the percentage of profits plowed back in 1951 will be higher than any year since 1938. Moreover, it shows that compared to profits, the additions of new plant and equipment in 1951 do not necessarily constitute over-expansion.

While these new production facilities were being provided, their effect was inflationary. This is because money and materials were being poured into enterprises that temporarily were not producing goods, thereby increasing the money supply without increasing the supply of goods. However, as soon as these plants go into production their effect will be a deflationary one.

Therefore, we see that to offset the inflationary forces we have enormously increased productive facilities and that there has been some effort on the part of the government to control credit. While the outlook for the next few months will be mildly inflationary, probably growing more intense toward the middle of 1952, we would not be surprised to see the pendulum swing the other way within the next 12 to 18 months. This is, of course, a guess based on the present situation - significant change in credit or fiscal policy could cause revisions in our views.